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SUBJECT: Ukraine: Struggle for Nikopol Ferroalloy Works Nearing
Endgame?

KYIV 00001092 001.2 OF 003

Summary

1. (U) Pitting oligarch against oligarch and featuring surprising plot twists and turns, the two-year struggle over the ownership of Ukraine's Nikopol Ferroalloy Works (NFW) makes for nearly as good drama as the country's prolonged political crisis. The State Property Fund (SPF) has been trying since 2005 to reverse its questionable 2003 sale to oligarch Viktor Pinchuk of a majority share in NFW, but despite court victories, has been unsuccessful. In April, after a secret Supreme Court ruling favorable to Pinchuk and under the threat of a share dilution scheme that would have devalued the disputed majority holding, it appears that the GOU and Pinchuk are on the verge of reaching a settlement that could allow him to retain his control of the company by paying an additional sum to the state. In getting to this point, Pinchuk temporarily teamed up with rival oligarch and NFW minority shareholder Igor Kolomoisky against the SPF, but now seems to have double-crossed Kolomoisky in order to seek a deal with the state. The case illustrates clearly the shortcomings in Ukraine's laws and court system. End Summary.

The Prize

2. (U) Nikopol Ferroalloy Works is one of the world's biggest producers of ferroalloys, accounting for about 10% of global production. It is the world's leading producer of manganese alloys. NFW's estimated total value is now around \$1 billion, and its annual profits, though allegedly understated for tax purposes, could be as high as \$500 million, according to the press. NFW is owned by the two leading Dnipropetrovsk oligarchs: Viktor Pinchuk, Chairman of the Interpipe holding company, and Ihor Kolomoyskiy, who heads the Pryvat Group. In May and August 2003, the State Property Fund (SPF) sold blocks of stocks totaling 50% plus one share of NFW to Interpipe's 'Prydniproviye' consortium for \$77.5 million. At the time, Pinchuk already owned 23% of the NFW's shares, with 26% under the control of Kolomoyskiy. Like the subsequent sale of the Kryvorizhstal steel plant, it was apparent that the two NFW tenders were rigged in favor of Pinchuk--the son-in-law of then-President Leonid Kuchma--for a cut-rate price. Then SPF Head Chechetov, currently a Regions MP, admitted to investigators that he had steered the two tenders to Pinchuk on the direct orders of Kuchma. The true value of the share was likely closer to the UAH 350 million

a Russian consortium allegedly offered Pinchuk for it in early 2005.

NFW Reprivatization and Tymoshenko's Downfall

13. (U) After the Orange Revolution, with the public support of both President Yushchenko and Prime Minister Tymoshenko, the Prosecutor General launched the NFW reprivatization effort in court. In August 2005, the High Economic Court in Kyiv declared the 2003 sale of 50%+1 stake invalid on the grounds that the sale was conducted below market price and ordered the transfer of the NFW shares back to the state. Immediately thereafter, and allegedly with Tymoshenko's support, Kolomoisky's Pryvat group held an emergency shareholders meeting at which he maneuvered the election of new management, giving nominal control to the State Property Fund, but placing Pryvat figures in key positions. In response, Pinchuk arranged for public demonstrations of his workers, which induced the Ministry of Interior to send in riot police. Yushchenko intervened, and, while he said the court ruling had been "deeply correct," he called Tymoshenko's involvement in favor of Kolomoisky "the last straw," in citing his grounds for firing her along with her government in September 2005.

Legal Shell Game: Best Justice Money Can Buy?

14. (SBU) Pinchuk used three tactics to defend his NFW interest: he conducted a public relations campaign pointing out that reprivatization under Tymoshenko was almost exclusively directed against him; he took advantage of the jurisdictional ambiguities in the Ukrainian judicial system, winning court decisions to counter other court judgments against him; and, he blocked execution of the court order that the shares be returned to the state. (Comment: It was not difficult for Pinchuk to portray Tymoshenko's ill-starred reprivatization campaign as a vendetta against Interpipe, since her chief targets were indeed part of his empire, while Kolomoisky's

KYIV 00001092 002.2 OF 003

Pryvat holdings were suspiciously absent from the list of planned reprivatizations. End Comment.)

15. (U) In January 2006, the Supreme Court confirmed the illegality of the 2003 privatization and ordered the transfer of the 50%+1 share back to the state. An inability to determine which of two stock registers actually controlled Pinchuk's NFW shares delayed execution of this order. In September 2006, however, Pinchuk struck back, winning a decision in the Kyiv economic court declaring Prydniprovya the rightful owner. The Kyiv Economic Court of Appeal upheld this ruling in October, 2006. The GOU countered with a victory in the Supreme Commercial Court on February 1, 2007, annulling the two pro-Pinchuk rulings and ordering Pinchuk's Ukrsootsbank to hand over the stake to the SPF. Ukrsootsbank, backed by yet another court decision--this time from the Kyiv Vyshhorod District Court--did not comply, on the grounds that it had already transferred the stocks to Ihor Kolomoisky's Pryvatbank.

Rival Oligarchs Seem to Join Forces

16. (SBU) This transfer of NFW shares from Ukrsootsbank to Pryvatbank was a sign of a rapprochement between Pinchuk and Kolomoisky that had two elements at its heart: a withdrawal of Kolomoisky's evidence against the 2003 NFW privatization, and a scheme to devalue the disputed majority share of the company. (Note: In mid-February, Pinchuk told Ambassador that he and Kolomoisky had agreed to cooperate in the metallurgical sphere, and that both were now equally opposed to an SPF takeover of NFW. End Note.) The alliance with Kolomoisky paid off in the courts. On April 20, 2007, a spokesman for Pinchuk announced that the Administrative Chamber of Ukraine's Supreme Court had quietly issued a ruling a month earlier (March 14) canceling the 2005 and subsequent rulings that the Nikopol privatization had been illegal. According to the press, the chamber based the decision on Pryvat's retraction of evidence it had originally presented proving the illegality of the 2003 sale. The Chamber referred the case for reconsideration to the Kyiv High

Commercial Court, where, in the absence of Pryvat's evidence, Pinchuk is likely to prevail. The SPF, apparently until then unaware of this ruling which had somehow not been made public, vowed to appeal.

¶7. (U) The second element was a plan to have an April 26 NFW shareholders meeting increase the company's statutory fund and issue new stock, thus diluting the value of the disputed 50%+1 share block down to 10%. (Note: Such schemes are a Kolomoiskiy specialty.) The additional shares would go to Pinchuk and Kolomoiskiy, presumably in proportion to their shares in the company. As a consequence, even if the SPF ultimately prevailed in court, the prize it would win would be greatly reduced in value. The SPF lodged a last-minute appeal to a Dnipropetrovsk court to block participation by Prydniprovya in the shareholders meeting, even persuading Deputy Prime Minister Azarov to submit a letter to the court requesting it grant the SPF's request. Despite the pressure tactics, the court ruled against the SPF on April 25, permitting the shareholders meeting to go forward.

Stab in the Back?

¶8. (SBU) Nonetheless, the planned Pinchuk-Kolomoiskiy stock dilution scheme did not come to pass. On April 26, representatives of Pinchuk's Prydniprovya failed to appear at the shareholders meeting, depriving it of a quorum. According to press accounts, this came as a surprise to the Kolomoiskiy forces assembled at the meeting hall. In the meantime, press reports emerged that Pinchuk was negotiating directly with the Cabinet of Ministers on a final resolution of the dispute. The newspaper "Kommersant" quoted privatization expert Alexander Rabchenko, who contended that the negotiations were aimed at a "peaceful solution," i.e. most likely a plan whereby Pinchuk would pay the state a sum of money and be allowed to retain the stock he purchased in 2003. (Comment: Ironically, Pinchuk has been telling us since 2005 that he would be willing to reimburse the GOU for some or all of the difference between the price he actually paid and a fair market value (ca. 2003) of the shares he purchased. In February 2007, he reiterated that willingness to the Ambassador, but complained that the GOU had never approached him to make such a deal. His recent court victory and the threat of stock dilution may have motivated the GOU to reconsider. End Comment.)

KYIV 00001092 003.2 OF 003

¶9. (SBU) On May 4, SPF First Deputy Chairman Viktor Petrov confirmed to Deputy Econ Counselor that such negotiations were underway, but indicated that the SPF itself was not involved. He said he was eager to see the proposal of the "other side." Petrov blamed the NFW fiasco on the ambiguities in Ukrainian law, and in particular in the unclear jurisdiction of its various courts. Although the status of the Pinchuk-GOU negotiations are not known, Interpipe has since renewed its threat to participate in the stock dilution scheme at a prospective May 17 shareholders meeting.

Comment

¶10. (SBU) If Interpipe's no-show at the shareholders meeting came as a surprise to Kolomoiskiy, it would seem that, in addition to outplaying the SPF, Pinchuk has neatly planted a ferroalloy dagger between Kolomoiskiy's shoulder blades. Having persuaded Pryvat to withdraw its legal case against the 2003 NFP privatization, Pinchuk perhaps saw the opportunity to gain undisputed control of NFP as more attractive to him than a stock-dilution scheme, which might well have left Pryvat as the largest single shareholder in NFW. A double-crossed Kolomoiskiy would not be likely to take defeat graciously, however, and his collaboration with Pinchuk may be more complex even than meets the eye. More chapters of the NFW saga are surely still to be written. Meanwhile, the episode underscores that in Ukraine's business world, as in its politics, problems are solved through deal-making between powerful individuals, not through the manipulable court system.

TAYLOR